The Economic Foundation of the Dormant Commerce Clause

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THE ECONOMIC FOUNDATION OF THE DORMANT COMMERCE CLAUSE

Michael S. Knoll and Ruth Mason*

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“[T]he mathematician Stanislaw Ulam . . . used to tease me by saying, ‘Name me one proposition in all of the social sciences with is both true and non-trivial.’ This test I always failed. But now, some thirty years later, on the staircase so to speak, an appropriate answer occurs to me: The Ricardian theory of comparative advantage.”

--Economist Paul Samuelson

Last Term, a sharply divided Supreme Court decided a landmark dormant Commerce Clause case, Comptroller of the Treasury of Maryland v. Wynne. Wynne represents the Court’s first clear acknowledgement of the economic underpinnings of one of its main doctrinal tools for resolving tax discrimination cases, the internal consistency test. In deciding Wynne, the Court relied on economic analysis we provided. This Essay explains that analysis, why the majority accepted it, why the dissenters’ objections to the majority’s reasoning miss their mark, and what Wynne means for state taxation. Essential to our analysis and the Court’s decision in Wynne is the idea that states are capable of discriminating not only on an inbound basis, but also on an outbound basis, and that the Commerce Clause prohibits discrimination on either basis. To aid in explicating our position, this Essay introduces the term “retentionism” as an analogue to protectionism. Whereas taxes or regulations are protectionist when they discourage outsiders from engaging in economic activities within a state, taxes or regulations are retentionist when then discourage in-state economic actors from engaging in out-of-state activities. As we show, the tax struck down in Wynne was both protectionist and retentionist.

I. Introduction...................................................................................2

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I. INTRODUCTION

Last year, in *Comptroller of the Treasury of Maryland v. Wynne*, an unusually aligned and closely divided Supreme Court struck down a Maryland state tax regime as inconsistent with the dormant Commerce Clause of the U.S. Constitution. Under the challenged regime,
Marylanders paid county tax of up to 3.2 percent on their income, regardless of whether they earned it inside or outside Maryland. Against the county tax due on income earned outside the state, Maryland offered no credits for other states’ taxes. These rules resulted for the Wynnes in unrelieved double taxation. At the same time, Maryland imposed a tax of 1.25 percent on the Maryland income of residents of other states.

Commentators hailed Wynne as the most important state tax decision in decades, and even the most important Supreme Court decision last Term. How is it possible a state tax case has a claim to be the most important decision in a Term that saw landmark decisions on marriage equality, redistricting, lethal injection, and the interpretation of the Affordable Care Act?

Before Wynne, because there was no clear description of tax discrimination that applied in every case, courts and litigants relied on intuition to identify discrimination, which predictably led to claims that the concept was unprincipled. Some of the harshest criticism came from the Supreme Court itself. As far back as the 1940’s, the Court referred to its tax discrimination jurisprudence as a “quagmire” and “tangled underbrush.” Such criticism has not ebbed. For example, in his dissent in Wynne, Justice Scalia described the “glaring defect” of the dormant Commerce Clause as “its lack of [a] governing principle.” He criticized

\[4\] Gary Thompson, Op-Ed: A Tax Case (Yes, Tax) Was Last Term’s Blockbuster, NAT’L L. J. (Aug. 31, 2015) (highlighting Wynne as the standout in what he described as last Term’s “epic docket”). See also Brannon P. Denning & Norman R. Williams, Wynne: Lose or Draw?, 67 VAND. L. REV. EN BANC 245, 245 (2015) (describing Wyne as “the most important state tax case since . . . 1992”); id. (quoting practitioner’s perspective that Wynne was “probably the most important U.S. Supreme Court case . . . in the last 30 years”).


\[9\] Nw. States Portland Cement v. Minnesota, 358 U.S. 450, 457-58 (1959); see also Wardair Canada, Inc. v. Fla. Dep’t. of Revenue, 477 U.S. 1, 17 (1986) (Burger, C.J., concurring in part and concurring in the judgment) (referring to “the cloudy waters of this Court’s ‘dormant Commerce Clause’ doctrine”).


\[11\] Wynne, 135 S.Ct. at 1809 (Scalia, J., dissenting).
the Court’s doctrine for its “instability,” calling it a “bestiary of ad hoc tests and ad hoc exceptions.” Likewise, prominent commentators have described the Court’s tax nondiscrimination doctrine as “confused and inconsistent,” as having a “wild west quality to it” and “characterized by meaningless distinctions, encrusted rules, and a lack of principled analysis.”

Such criticism is typical of tax nondiscrimination standards, which also appear in tax treaties and the Treaty on the Functioning of the European Union (TFEU). Even in contexts where prohibitions of tax discrimination have an explicit textual basis, and thus cannot be criticized as representing judicial lawmaking, the interpretation of such provisions justly has been criticized as incoherent.

In Wynne, the Supreme Court clarified its approach in dormant Commerce Clause cases to balancing state tax autonomy against the integrated national market. The Court did so by renewing its commitment to its own internal consistency test for identifying unconstitutional discrimination. Importantly, the Court announced that the test should apply broadly to all kinds of taxes levied against all kinds of taxpayers. The test is simple and powerful. When faced with a dormant Commerce Clause challenge to a state’s tax rules, the reviewing court should assume that all fifty states apply the challenged rule. If, under the fifty-state harmony assumption, cross-border commerce would bear more tax than purely in-state commerce, then the state tax is internally inconsistent and unconstitutionally discriminatory. When we universalize the Maryland tax

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12 Id. (Scalia, J., dissenting). Justice Scalia describes the Court’s practice in this area dating back to the 1870’s as tending “to revamp the doctrine every couple of decades upon finding existing decisions unworkable or unsatisfactory.” Id. at 1808.

13 Id. at 1809 (Scalia, J., dissenting).


15 Kaye, supra note 14, at 91 (quoting Professor Kirk Stark).

16 Kaye, supra note 14, at 91, n.278 (quoting Professor Walter Hellerstein).


18 See, e.g., Luc Hinnekens & Philippe Hinnekens, General Report, 93a CAHIERS DE DROIT FISCAL INT’L 15, 50 (2008) (surveying enforcement of tax nondiscrimination in two dozen countries’ domestic laws, in EU law, and under tax treaties and concluding that across those contexts, its interpretation is “theoretical and arcane”); Justices of the United States Supreme Court have also criticized the doctrine. See Nw. States Portland Cement v. Minnesota, 358 U.S. 450, 457-458 (1959); see also Wardair Canada Inc. v. Fla. Dep’t. of Revenue, 477 U.S. 1, 17 (1986) (Burger, C.J., concurring in part and concurring in the judgment) (referring to “the cloudy waters of this Court’s ‘dormant commerce clause’ doctrine”).
regime challenged in *Wynne*, in-state income is always taxed at 3.2 percent, but interstate income is always taxed at 4.45 percent. The Court concluded that because it burdened interstate commerce more than in-state commerce, Maryland violated the Constitution. We show that the Maryland tax regime was what we call retentionist, it discouraged residents from engaging in out-state-activities. Retentionist policies are the mirror-image of protectionist policies, and they similarly distort interstate commerce.

The internal consistency doctrine traces its origins to the 1970s and early 1980s, but in recent cases the Court had repeatedly narrowed the application of the test, leaving commentators to wonder about its continued relevance. Prior to *Wynne*, the Supreme Court had not struck down a state tax as internally inconsistent in thirty years. *Wynne* not only removed doubts about the continued relevance of the test, but it acknowledged, for the first time, that economic analysis supports using internal consistency to test for unconstitutional discrimination in tax cases. Of the fourteen amicus briefs filed in *Wynne*, two presented the economic case for the internal consistency test. While each brief made the case in its own way, both briefs made essentially the same economic argument. We wrote one of those briefs, and the other was written by eight prominent tax economists (the Tax Economists’ Brief). The *Wynne* majority repeatedly referenced both briefs in its decision.

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19 See *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S., 159, 169 (1983) (articulating requirement of internal consistency); *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978) (applying an internal-consistency analysis to conclude that a state was free to adopt an apportionment formula that differed from the formula used by forty-four of the forty-six states imposing an income tax).


21 *Wynne*, 135 S.Ct. at 1821 (Ginsburg, J., dissenting).


23 *Wynne*, 135 S.Ct. at 1802, 1804, 1806.
We argued in the brief, as we have in our academic work, that the economic principle that motivates legal prohibitions on tax discrimination is what we call “competitive neutrality” or “a level playing field.”

Competitive neutrality is the idea that states should not use their tax systems to distort the competitive advantages of residents of different states. Our earlier work provided support for that doctrinal conclusion in both the EU and U.S. contexts. We showed in our amicus brief that the internal consistency test is a simple and predictable guideline for determining whether a state’s tax rate regime is competitively neutral, and we therefore urged the Supreme Court to uphold the decision of the Maryland Court of Appeals to strike down the challenged Maryland law because it was internally consistent. The Tax Economists’ Brief took the same position. In , the Supreme Court not only renewed its commitment to the internal consistency test, but the majority made clear that a reason it endorsed internal consistency was the congruence between the test and the economic analysis that we and the tax economists presented in our amicus briefs.

Although the majority put the internal consistency test on a firmer theoretical footing by referring to the economic analysis in the two briefs, the Court did not repeat our analysis in its opinion. Similarly, while acknowledging the majority’s reliance on the briefs, the dissent declined to address (or refute) the economic analysis we offered. This makes it more difficult to conclusively draw the lesson from that the dormant Commerce Clause’s nondiscrimination principle promotes competitive neutrality. Adding complexity, the parties in framed

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25 See Tax Discrimination, supra note 24, at 1085-1097, 1106-115 (dealing mostly with EU cases, but also arguing that the same principle was at work in the U.S. jurisprudence). See generally Alan D. Viard & Ryan Lirette, State Taxation of Interstate Commerce and Income Flows: The Economics of Neutrality, AEI Working Paper 2014-07 (Sept. 23, 2014) (providing in-depth analysis of the U.S. doctrine).

26 Knoll and Mason Brief, supra note 22, at 18–24

27 Tax Economists’ Brief, supra note 22, at 23–27.

28 , 135 S.Ct. at 1804.

29 , 135 S.Ct. at 1801–06.

30 , 135 S.Ct. at 1822, n.7 (Ginsburg, J., dissenting) (“[t]he majority faults the dissent for not ‘disput[ing]’ its ‘economic analysis,’ but beyond citation to a pair of amicus briefs, its opinion offers no analysis to dispute”) (quotation marks in original).
the central issue in the case as whether the dormant Commerce Clause requires a state to relieve double taxation. These two notions—double taxation and tax discrimination—are not identical, and conflating them gives rise to persistent confusion that pervades dormant Commerce Clause doctrine, including the principal dissent in Wynne.

This Essay seeks to explain the significance of Wynne by exploring why the majority ruled as it did, why the dissenters’ objections to the majority’s reasoning miss their mark, and what Wynne means for state taxation. The next Part of this Essay provides a brief introduction into the dormant Commerce Clause and the Court’s tax discrimination jurisprudence. It also describes the facts of Wynne. Part III explores our theory that the dormant Commerce Clause promotes competitive neutrality. In Part IV, we show that the internal consistency test accurately identifies state tax rate structures that violate competitive neutrality. As a result, we argue, as we did in our amicus brief, that the Court’s internal consistency doctrine has a firm economic foundation. We also show that the Maryland tax regime challenged in Wynne was internally inconsistent. Part V describes the Wynne majority’s endorsement of the internal consistency test, which relied on the economic analysis in our amicus brief and that of the Tax Economists. In Part VI, we critically examine the dissenting Justices’ main criticisms of the Court’s opinion, especially its arguments against the internal consistency test. We show that when the Court’s opinion is properly understood as addressing tax discrimination, rather than double taxation, the dissenting Justices’ objections lose their force. Part VII concludes.

II. THE FACTS OF WYNNE

The facts of Wynne are simple. Brian and Karen Wynne, a married couple resident in Maryland, owned stock in Maxim Healthcare Services, Inc. (Maxim), a Maryland corporation engaged in business throughout the

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32 See Ruth Mason, Made in America for European Tax: The Internal Consistency Test, 49 B.C. L. Rev. 1277, 1284-1289 (2008). A similar problem arises in the context of personal tax benefits, where courts have sometimes held that a cross-border taxpayer must receive benefits, such as the personal exemption, exactly once, somewhere. Our work shows that maintenance of competitive neutrality does not require fidelity to the “once, somewhere” principle. Tax Discrimination, supra note 24, at 1083 (concluding that “[c]hecking for double recoveries or double denials is no more effective a way to identify violations of competitive neutrality than is comparing absolute tax rates”). See also Perseus, supra note 24, at 421-422 (providing numerical example).
Because it was an S-corporation, Maxim paid no federal income tax; instead, Maxim passed through to its shareholders all items of income and expense (including states tax paid), which Maxim’s shareholders, including the Wynnes, reported pro-rata on their personal federal income tax returns.\footnote{Wynne, 135 S.Ct. at 1793.}

As residents of Maryland, the Wynnes had to pay Maryland tax on Maxim’s income, no matter where Maxim earned it.\footnote{Wynne, 135 S.Ct. at 1792–93.} They also had to pay taxes on Maxim’s income to the states where Maxim earned it.\footnote{Wynne, 135 S.Ct. at 1792.} The dispute arose because Maryland did not credit taxes the Wynnes paid to other states against their Maryland tax on the same income.\footnote{Id.} Thus, they paid more tax on their income from other states than they would have paid on the same income, had they earned it in Maryland.\footnote{Id.} Phrased this way, it is easy to see why the parties, justices, and commentators originally understood this case to challenge the constitutionality of double taxation. Later, we will differentiate discrimination and double taxation, but for now, we provide a little more detail on the challenged Maryland regime, which contained the following elements:\footnote{Maryland formally divides its individual income tax into two portions: a progressive “state” portion and a flat “county” portion, which varied by county. In 2006, the year in question, the “state” portion had a maximum rate of 4.75%, and the “county” portion varied depending upon county from 1.25% to 3.2%. The State collects both portions of the tax, but it remits the “county” portion to the counties. Md. T.G. § 10-703(a). Maryland allows its residents a credit against their “state” tax liabilities for taxes paid to other states up to the full amount of their “state” tax liability (a full credit). \textit{Id.} Maryland, however, does not allow its residents any credit against their “county” tax liabilities for taxes paid to other jurisdictions. \textit{Id.} As a result, the Wynnes’ challenge implicated the “county,” rather than the “state” tax, and for simplicity we therefore deal only with the “county” portion of the tax.}

\footnote{Maryland follows federal tax law in treating S-corporations as pass-through entities. \textit{Wynne}, 64 A.3d at 457–60.}{Maryland follows federal tax law in treating S-corporations as pass-through entities. \textit{Wynne}, 64 A.3d at 457–60.}
For residents:

1. On income earned in Maryland, tax of 1.25% to 3.2%, depending on the county of residence (*domestic tax* or *Td*)\(^{40}\)

2. On income earned in other states, tax of 1.25% to 3.2%, depending on the county of residence (*outbound tax* or *To*) with no credit for other state’s taxes\(^{41}\)

For nonresidents,

3. On income earned in Maryland, tax of 1.25% (Maryland calls this the Special Non-Resident Tax or SNRT; we also call it the *inbound tax* or *Ti*)\(^{42}\)

4. On income earned in other states, no tax.

The Wynnes resided in Howard County, where the tax rate was 3.2%, so the Wynnes paid tax of 3.2% on their domestic and outbound income. *Figure 1* schematically represents the challenged Maryland tax regime for Howard County.

**Figure 1. Maryland County Tax Regime**

<table>
<thead>
<tr>
<th>Activity in Another State</th>
<th>Maryland Resident</th>
<th>Resident of Another State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outbound Tax (<em>To</em>)</td>
<td>3.2%</td>
<td>N/A</td>
</tr>
<tr>
<td>Domestic Tax (<em>Td</em>)</td>
<td>3.2%</td>
<td>Inbound Tax (<em>Ti</em>)</td>
</tr>
</tbody>
</table>

III. Tax Nondiscrimination as Competitive Neutrality

The Supreme Court has applied dormant Commerce Clause analysis to a wide range of cases, and unsurprisingly given the anti-tariff origins of dormant Commerce Clause jurisprudence, many of those cases involve state taxes. The most important preliminary in any dormant Commerce Clause inquiry is to acknowledge that a state does not violate
the dormant Commerce Clause merely by discouraging interstate commerce. All taxes discourage commerce. But many taxes that discourage interstate commerce do not offend the Constitution. For example, high tax rates in one state discourage commerce in that state by both residents and nonresidents. Such distortions are inevitable in a federal tax system that allows states autonomy to set their own tax rates. The dormant Commerce Clause only restrains certain distortions of interstate commerce; this Part describes our view on the specific kind of distortion the dormant Commerce Clause forbids, namely, distortions to what we call competitive neutrality. *Wynne* makes clear that a majority of the Supreme Court shares out view.43

The Commerce Clause of the Constitution grants Congress the power “to regulate commerce with foreign nations, and among the several states, and with the Indian tribes.”44 By its own terms, the Commerce Clause does not restrict state governments, but only grants power to Congress. The dormant Commerce Clause “is the doctrine that the Commerce Clause, by its own force and without national legislation, puts it into the power of the Court to place limits on state authority.”45 Although courts and scholars have endlessly debated whether the Commerce Clause should be interpreted to restrict state action even in the absence of direct Congressional action, the Court has long interpreted the Commerce Clause to limit state action.46

The dormant Commerce Clause prevents the states from enacting economic policies, especially tariffs, that advantage in-state commerce over cross-border commerce.47 Scholars and jurists recognize that dormant Commerce Clause doctrine aims to develop and maintain a smoothly functioning national marketplace.48 Thus, for example, in 1949 the Court wrote that “[o]ur [economic] system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the

43 See infra Part V.
44 U.S. CONSTITUTION, ART. I, sec. 8, cl. 3.
48 Underlying the Commerce Clause is the framers’ “conviction that in order to succeed the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.” Hughes v. Oklahoma, 41 U.S. 322, 325- 26 (1979).
Nation…” Under the Court’s doctrine, state taxes violate the dormant Commerce Clause when they *discriminate against* or *unduly burden* interstate commerce.50

In prior work, we primarily focused on the European Union when making the doctrinal case for a competitive neutrality interpretation of tax discrimination, although we also discussed the dormant Commerce Clause.51 In a working paper, Alan Viard, the principal author of the Tax Economists Brief, and Ryan Lirette argue that the Supreme Court’s dormant Commerce Clause doctrine should promote competitive neutrality.52 Although we argue that doctrine reveals competitive neutrality to be the value undergirding the dormant Commerce Clause, we did not invent the idea of competitive neutrality out of thin air. We base our approach to tax discrimination on a solid economic foundation: the age-old economic principle of comparative advantage, which holds that an economic actor (e.g., a nation, corporation, or individual) will specialize in those activities where it enjoys a comparative advantage and will avoid those activities where it has a comparative disadvantage.

In the absence of tariffs, quotas, taxes or other potential distortions, the activities an economic actor specializes in are determined not by absolute advantage, but rather by comparative advantage.53 Policy instruments, such as tariffs, can distort economic activity by changing an actor’s perceived (in our case, after-tax) comparative advantage relative to its actual comparative advantage. When we translate the idea of comparative advantage from the familiar context of tariffs on goods and services to the less familiar context of taxes on income, *earning income* takes the place of *production of goods and services*. Whereas tariffs distort


50 See Complete Auto Transit, Inc., v. Brady, 430 U.S. 976 (announcing the modern approach to resolving dormant Commerce Clause challenges to state taxes).

51 See Tax Discrimination, supra note 24, at 1085-1097 (EU context). Id. at 1106-1115 (United States context). Among other examples, we cited West Lynn Creamery, in which the Supreme Court struck down under the dormant Commerce Clause a state tax regime because it “neutraliz[ed] the advantage possessed by lower cost out-of-state producers” and “artificially encourage[d] in-state production even when the same goods could be produced at a lower cost in other states.” West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 193-194 (1994).

52 Viard & Lirette, supra note 25 (relabeling competitive neutrality “commerce neutrality” to emphasize its relevance to the dormant Commerce Clause).

which goods and services a state produces, discriminatory income taxes distort in which state a person earns income.54

In our view, every discriminatory tax results in two distortions to where people earn income, and these distortions run in opposite directions. When the state’s tax regime undermines the comparative advantage of nonresidents who earn income within the state relative to residents who earn income in the state, economists refer to the regime as protectionist. Economists have not invented a special term to describe the distortion that happens when a state’s tax regime undermines the comparative advantage of residents compared to nonresidents on income earned outside the state. We refer to such distortions as retentionist. The Wynnes complaint involved the retentionist impact of Maryland’s tax regime—specifically, they argued that Maryland discouraged them from earning out-of-state income. Although the complementary distortion caused by the Maryland tax regime that ran in the opposite direction was not at issue in Wynne, we can describe it. Because the Maryland tax regime discouraged Marylanders from earning out-of-state income, it upset the comparative advantage nonresidents may otherwise have had over Marylanders when competing for work and investments in Maryland. In other words, the Maryland regime that the Wynnes challenged was also protectionist. Indeed, at least some nonresident taxpayers understood this effect well enough to challenge the same Maryland regime as protectionist in Frey v. Comptroller, a case decided four years prior to Wynne.55 We discuss Frey later.56

In contrast with our comparative advantage approach, it is common and (to most non-economists) intuitive to assume that the impact of taxes on competition can be understood by comparing absolute tax rates. That intuition is wrong. Assume, as in Wynne, that we are trying to determine the impact of Maryland’s tax regime on interstate commerce. To do so, we need to look beyond Maryland to alternative investments open to Marylanders and residents of other states. The competitive position of an economic actor considering working or investing in a particular market is

54 Our approach is also closely related to the literature on capital ownership neutrality (CON). See generally Tax Discrimination, supra note 24, at 1051–72. A tax system is said to promote CON when it does not distort who owns capital. In contrast, a tax system is said to promote capital export neutrality (CEN) when it does not distort where (in which jurisdiction) taxpayers invest their capital. Id. Our argument is that the dormant Commerce Clause is concerned with the “who” question, not the “where” question. When we refer to discouraging interstate commerce relative to in-state commerce (and the shorthand “discouraging interstate commerce”), we refer to refer to distortions of ownership, not location.


56 See discussion accompanying infra notes 65 to 72.
determined by simultaneously comparing tax rates across both taxpayers and economic opportunities. Crucial to this economic analysis is the idea, widely accepted in economics, that people make decisions based on comparisons of their options across different markets. Thus, to identify the impact of state taxes on economic actors, we must compare

1) how an economic actor is taxed in the particular market under consideration relative to how that actor is taxed in alternative markets with

2) how that actor’s competitors are taxed in the particular market relative to the alternative markets.57

Thus, we must compare two comparisons. And accordingly, even if Maryland taxes nonresidents at a lower rate than residents on income earned in Maryland, it does not follow that Maryland provides nonresidents with a tax-induced competitive advantage over residents for income earned in Maryland. Rather, an actor has a competitive advantage in a particular market over a second actor only if the share of pre-tax income retained by the first actor in that market relative to the share of pre-tax income retained by that actor in other markets exceeds that same ratio for the second actor.58

Our approach is also consistent with commonly observed behavior. Residents of high-tax states (such as California and New York) hold many investments despite being taxed more heavily on those same investments than potential investors from lower-taxed states (such as Florida). If absolute tax rate advantages were determinative, residents of high-tax states would be discouraged from holding investments in low-tax jurisdictions and from holding investments, such as equities and debt, which are taxed only where the holder resides.

As this short discussion suggests, and as our prior work shows in detail, deciding whether a tax system is neutral between intrastate and interstate commerce (is “competitively neutral” in our parlance) requires consideration of how a state taxes both residents and nonresidents on both in-state and out-of-state income.59 Our principal result can be expressed as requiring that all taxes be assessed on either a uniform source or a uniform residence basis.60 A source tax is uniform if it applies at the same rate and

57 Tax Discrimination, supra note 24, at 1060-1072; Perseus, supra note 24, at 436-452.
58 Tax Discrimination, supra note 24, at 1060-1072.
59 Perseus, supra note 24, at 436-452 (numerical derivation of these principles).
60 Tax Discrimination, supra note 24, at 1060-74 (describing uniformity requirements for taxes not to distort competition).
on the same base\textsuperscript{61} to both residents’ and nonresidents’ income from the state. A residence tax is uniform if it applies at the same rate and on the same base to residents’ in-state and out-of-state income. Accordingly, if a state taxes on both a source and residence basis, it must apply both source and residence taxes to its residents’ in-state income.\textsuperscript{62}

The uniformity rule can be used to evaluate any tax discrimination claim, whether it involves a challenge to the tax rates or the tax base, or both. In the limited situation, as in \textit{Wynne}, where a taxpayer challenges only the tax rates (not the tax base), the above logic reduces to a simple mathematical formula. The requirement that a state must apply both its source and residence taxes to its own residents (coupled with a recognition that the dormant Commerce Clause prohibits discouraging interstate commerce relative to intrastate commerce, but does not prohibit encouraging such interstate commerce relative to in-state commerce) implies that the tax rate assessed by a state on its residents’ domestic-source income, $T_d$, must equal or exceed the combined tax imposed on domestic residents’ out-of-state income, $T_o$, and nonresidents’ in-state income, $T_i$. Arithmetically, this can be written as:

$$T_d \geq T_o + T_i - (T_o \times T_i)$$

That is, the tax rate applied to the domestic income of residents must equal or exceed the sum of the tax rates paid by residents on out-of-state income and by nonresidents on domestic income less the product of those two rates. If a state’s tax rates do not satisfy Equation 1, its tax system discourages interstate competition.\textsuperscript{64} Notice that Equation 1 does not specify the rates; rather it specifies the relationship among the rates. A state may set its tax rates high or low. And a state can set any two of the three tax rates in Equation 1 as it chooses. However, the choice of those two rates restrains the third. Thus, the dormant Commerce Clause prevents a state from setting its tax on domestic income independently from its tax on interstate (inbound and outbound) income.

In contrast with our approach, when litigating disputes under the dormant Commerce Clause, states and taxpayers often argue that the

\textsuperscript{61} “Tax base” refers to the rules for calculating taxable income.

\textsuperscript{62} Tax Discrimination, supra note 24, at 1060-1072. Viard & Lirette, supra note 23, at 23 – 24.

\textsuperscript{63} The last term on the right side of the inequality represents the interaction between the tax laws of the source and residence states. It assumes that the residence state would allow a deduction from taxable income for the taxes assessed by the source state. For a numerical example, see infra note 120.

\textsuperscript{64} Perseus, supra note 24, at 436-41 (providing formal derivation of non-distortion conditions).
presence or absence of tax discrimination can be conclusively determined from comparisons of absolute tax rates.

For example, in *Wynne*, the Maryland Comptroller urged the Supreme Court to resolve the discrimination question by comparing Maryland’s *domestic tax rate* to Maryland’s *outbound tax rate*.\(^{65}\) To the Comptroller, the inbound rate was irrelevant in *Wynne*. But *Frey v. Comptroller*,\(^{66}\) the complementary case to *Wynne* mentioned earlier, helps to illustrate the problems that arise from ignoring a component of the state’s tax in interstate commerce. The Maryland Court of Appeals decided *Frey* in Maryland’s favor just four years before *Wynne*. *Frey* involved a challenge to the same Maryland tax regime at issue in *Wynne*, only in *Frey*, the taxpayer was a nonresident who earned income in Maryland and challenged the Maryland’s inbound tax rate.\(^{67}\) In defending the same tax regime at issue in *Wynne*, the Maryland Comptroller in *Frey* persuaded the Maryland Court of Appeals to resolve the discrimination question by comparing Maryland’s *domestic tax rate* to Maryland’s *inbound tax rate*.\(^{68}\) Since the inbound rate was lower than the domestic rate, the Maryland Court of Appeals never considered the impact on interstate commerce of the other component of Maryland’s tax regime, namely, Maryland’s outbound tax rate. The Controller’s framing in each case represents a simple comparison of absolute tax rates. Expressed mathematically, Maryland would write the non-discrimination condition as:

\[
T_d \geq T_i \text{ and } T_d \geq T_o.
\] (2)

Thus, combining *Frey* and *Wynne*, we can see that Maryland argued that as long as each of its inbound and outbound tax rates *taken alone* did not exceed its domestic tax rate, Maryland did not discriminate. Maryland ignored that the burden its tax system places on interstate commerce compared to in-state commerce depends on comparing the domestic tax rate to the *cumulative* burden Maryland places on interstate commerce, which only can be evaluated by considering Maryland’s *inbound and outbound taxes together*. Maryland’s argument is based on a mistaken implicit assumption—that the competitiveness of two taxpayers relative to one another in a specific market depends solely on absolute advantages, that is, on how those two taxpayers are taxed *solely by Maryland*.


\(^{67}\) *Id.* at 484.

\(^{68}\) *Id.*
Although the Maryland Comptroller’s reasoning may be intuitive, economic analysis shows that it is wrong. Absolute tax rate comparisons across competitors in the contested market (such as the Comptroller offered in both \textit{Wynne} and \textit{Frey}) are misleading. By disaggregating its inbound and outbound taxes, Maryland was able to persuade the Maryland Court of Appeals in \textit{Frey} that the Maryland regime did not offend the Constitution.\textsuperscript{69} But when the exact same regime was challenged in \textit{Wynne}, the same Maryland court found it unconstitutional.\textsuperscript{70}

The difference between \textit{Frey} and \textit{Wynne} was that in \textit{Wynne} the Court of Appeals used the internal consistency test.\textsuperscript{71} As we show below, the internal consistency test automatically aggregates a state’s taxes on inbound and outbound commerce, and therefore it prevents a state from obscuring discrimination against interstate commerce in disparate elements of its tax regime. As we explain in the next Part, the internal consistency test works because it tests for whether a state tax regime upsets comparative advantage.\textsuperscript{72} Thus it moves the inquiry away from the kinds of absolute comparisons offered by the Maryland Comptroller in \textit{Frey} and \textit{Wynne}.

IV. The Relationship between Competitive Neutrality and the Internal Consistency Test

Writing separate amicus briefs, we and the Tax Economists urged the Court to apply the internal consistency test in \textit{Wynne}.\textsuperscript{73} We (and they) advocated for the test for same reason: that test greatly aids courts in determining whether state tax regimes violate competitive neutrality.\textsuperscript{74} Before \textit{Wynne}, prominent commentators (and at least one Supreme Court Justice) failed to appreciate this aspect of the test, and instead they tended to regard internal consistency test as duplicating other doctrinal

\begin{itemize}
\item \textsuperscript{69} \textit{Id.} at 520.
\item \textsuperscript{70} \textit{Wynne}, 64 A.3d at 471.
\item \textsuperscript{71} \textit{Frey}, 29 A.3d. at 515–16, 520 (not applying internal consistency test); \textit{Md. State Comptroller of the Treasury v. Wynne}, 64 A.3d 453, 463–67 (Md. 2013) (applying internal consistency test).
\item \textsuperscript{72} See infra Part IV.
\item \textsuperscript{73} Knoll & Mason Brief, \textit{supra} note 22, at 2, 4, 10; Tax Economists’ Brief, \textit{supra} note 22, at 23–27.
\item \textsuperscript{74} Knoll & Mason Brief, \textit{supra} note 22; Tax Economists’ Brief, \textit{supra} note 22; \textit{See generally Tax Discrimination, supra} note 24 (arguing “that the principle of nondiscrimination in taxation should be understood as promoting competitive neutrality”); Viard & Lirette, \textit{supra} note 25, at 1 (providing an “economic interpretation of the requirement that state taxes not discriminate against interstate commerce”).
\end{itemize}
principles\textsuperscript{75} or, in the words of Justice Scalia, as unprincipled “ad hocery”.\textsuperscript{76} Because the virtue of the internal consistency test in identifying state tax regimes that violate competitive neutrality was unappreciated, it was far from obvious that the Court would redouble its commitment to the test in \textit{Wynne}. The opposite seemed possible because the Court had repeatedly narrowed the test since formally adopting it in 1983.\textsuperscript{77} Indeed, so precarious was the doctrine after a series of decisions narrowing it that in 2007 Walter Hellerstein, the leading expert on the application of the dormant Commerce Clause to state tax discrimination cases, wrote an article entitled, “Is Internal Consistency Dead?”

The Court’s clearest statement of the internal consistency test came in \textit{Jefferson Lines}:

[i]nternal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.\textsuperscript{78}

Thus, the internal consistency test directs a court to assume that every state enacts the challenged state’s tax regime, and then it asks

\textsuperscript{75} See Walter Hellerstein, \textit{Is “Internal Consistency” Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation}, 87 MICH. L. REV. 138, 188 (1988) (concluding that the Supreme Court could have decided cases in which it applied the internal consistency test by appeal to older dormant Commerce Clause doctrines rather than inventing a new test that “may introduce confusion and uncertainty in an area of the law that has had more than its fair share of both”). Such analysis fails to recognize that internal consistency test does a better job than other doctrines (such as fair apportionment) of effectuating the economic principle behind the dormant Commerce Clause, namely, competitive neutrality.

\textsuperscript{76} \textit{Wynne}, 135 S.Ct. at 1809.


whether, under such hypothetical harmonization, interstate commerce bears more tax than purely in-state commerce. Figure 2 shows how income would be taxed if every state (represented here by Delaware) adopted the Maryland tax regime as employed in Howard County:

**Figure 2. Maryland Tax Under the Internal Consistency Test**

<table>
<thead>
<tr>
<th>Activity in Delaware</th>
<th>Maryland Resident</th>
<th>Delaware Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4.45%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Activity in Maryland</td>
<td>3.2%</td>
<td>4.45%</td>
</tr>
</tbody>
</table>

As Figure 2 shows, the Maryland tax regime is internally inconsistent because under hypothetical harmonization domestic income (unshaded quadrants) would be taxed at only 3.2%, whereas cross-border income (shaded quadrants) would be taxed at 4.45%. Applying the internal consistency test, the Supreme Court, like the Maryland Court of Appeals before it, concluded that the Maryland tax regime violated the dormant Commerce Clause.\(^{79}\)

In urging the Court to apply internal consistency, we noted in our amicus brief the close similarity between the internal consistency test and both (1) our uniformity rule and (2) Equation 1. With regard to the first similarity, the internal consistency test reveals whether the state taxes uniformly on a source and residence basis. Uniform taxes pass the internal consistency test, non-uniform taxes fail it. The second similarity arises when the challenge is to a state’s system of tax rates (without credits), as in *Wynne*. In such situations, the internal consistency test is equivalent to Equation 1 and to our uniformity requirement.

The equivalence of the internal consistency test to both Equation 1 and the uniformity principle is easy to see. The unshaded quadrants in Figure 2 contain only the Maryland tax rate on domestic income \((T_d)\) in Equation 1. The shaded quadrants show the combined Maryland tax rate on outbound \((T_o)\) and inbound \((T_i)\) income. By directing a court to strike down a state tax unless the tax rate that appears in the two unshaded quadrants \((T_d)\) equals or exceeds the rate in the two shaded quadrants, the

\(^{79}\) See *Wynne*, 64 A.3d at 478.
court is simply applying *Equation 1*, which is just a mathematical statement of the uniformity principle. Thus, the internal consistency test asks the right question, although it presents it in a conceptual, rather than a mathematical, form.

V. THE MAJORITY’S ENDORSEMENT OF OUR ECONOMIC ANALYSIS

We argued in our amicus brief—and a majority of the Court agreed—that *Wynne* was a discrimination case. In contrast, the taxpayers, the Maryland Comptroller, the U.S. Solicitor General’s office, and the principal dissent framed the issue in *Wynne* as whether the Constitution forbids double state taxation.80 This Part describes the litigants’ arguments and the Court’s holding in *Wynne*.

The Wynnes and Maryland built their arguments on the same shaky economic foundation. Both sets of arguments derive from the mistaken premise that one can ascertain how taxes impact competition in a given market by comparing absolute tax rates paid by competitors in that market. The Wynnes argued that the relevant comparison was between (1) the total tax rate (both the source state tax rate and the residence state tax rate) they *actually paid* on interstate commerce and (2) the tax they *would have paid* on purely domestic commerce.81 Because Maryland did not account for the source state’s taxes, Maryland taxpayers who had income from other states paid higher total taxes on their out-of-state income than they would have paid on an equivalent amount of Maryland income.82 In the Wynnes’ view, the higher taxes they paid on outbound income

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82 At least when the other state imposed income taxes, which the vast majority do. Under Maryland’s system, which did not credit other state’s taxes, Maryland taxpayers who earned income outside Maryland would always pay at least the Maryland rate on those earnings, and if the other state taxed that income, it would pay tax at a higher rate.
discouraged them from earning income outside of Maryland and hence violated the Commerce Clause.\textsuperscript{83}

Maryland accepted the taxpayer’s frame—which compared the Maryland tax on residents’ domestic income to the Maryland tax on residents’ out-of-state income—but Maryland argued that it met its constitutional obligation by assessing those taxes at the same rate.\textsuperscript{84} Maryland argued that its only obligation was to avoid taxing residents’ out-of-state income at a higher rate than their in-state income. Any additional taxes the Wynnes paid were assessed by source states, not by Maryland. Thus, according to Maryland, if the Wynnes suffered a cross-border tax disadvantage that discouraged them from engaging in interstate commerce, the fault lied as much with the source state as with Maryland.\textsuperscript{85} Maryland had no control over whether the other state taxed the Wynnes, and Maryland argued that the other state’s tax should not preempt Maryland from taxing all its residents’ income at the same rate, no matter where they earned it.\textsuperscript{86}

Rather than objecting to the over-simplified tax rate comparison offered by Maryland, the Wynnes argued that double taxation violated the dormant Commerce Clause, and furthermore that, as their residence state, Maryland was obliged to relieve double state taxation.\textsuperscript{87} Thus, the Wynnes argument required them to argue that the Constitution included a priority rule that required the residence state to yield to the source state.\textsuperscript{88} Source-state priority to tax is well-established in international tax.\textsuperscript{89} And eminent state tax expert Walter Hellerstein argued that the Supreme Court in \textit{Wynne} ought to have recognized the source state’s priority to tax.\textsuperscript{90} But Maryland argued that because there was no constitutionally mandated tax-priority rule, it was not clear which state, if any, had to relieve double

\textsuperscript{83}Wynnes’ Brief, supra note 31, at 2.
\textsuperscript{84}Maryland Comptroller’s Brief, supra note 31, at 35.
\textsuperscript{85}Id. at 27–32.
\textsuperscript{86}Id. at 26–27.
\textsuperscript{88}Transcript of Oral Argument at 31, \textit{Wynne}, 135 S.Ct. 1787 (No. 13-485). Specifically, Justice Kagan asked counsel for the respondents: “you’re not saying that…we should establish a priority rule as to different taxing schemes…are you?” Counsel for the Wynnes replied, “I think that the holdings of this Court…are that in a situation where one State is taxing on the basis of residency and the other on the basis of source, it is the State of residency that yields.” \textit{Id.}
\textsuperscript{89}Tax Discrimination, supra note 25, at 1027.
\textsuperscript{90}Walter Hellerstein, \textit{Deciphering the Supreme Court’s Opinion in Wynne}, 123 J. TAX’N 4, 5 (2015).
taxation. Thus, Maryland argued that its authority to tax is residents’ out-of-state income was undiminished by the source state’s authority to tax the same income.

These double tax arguments are misdirected. As described in the last Part, whether a state tax regime violates the dormant Commerce Clause depends on its impact on cross-border commerce, not on whether it generates double taxation. The impact of a state tax regime on interstate commerce cannot be understood by examining only its residence rules, despite the arguments of both the Wynnes and Maryland. Instead, understanding the impact of Maryland’s tax regime on interstate commerce requires examining its entire tax regime, comprised of inbound, outbound, and domestic taxes. The internal consistency test allows a court to examine the whole regime.

Recognizing this, the Court set aside the litigants’ framing and instead analyzed the Maryland regime under the internal consistency test. Justice Alito wrote the majority opinion, joined by Chief Justice Roberts, and Justices Kennedy, Breyer, and Sotomayor. Citing its own precedent, our amicus brief and that of the Tax Economists, and our academic work, the majority wrote:

By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant State’s tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. The first category of taxes is typically unconstitutional; the second is not. Tax schemes that fail the internal consistency test will fall into the first category, not the second: “[A]ny cross-border tax disadvantage that remains after application of the [test] cannot be due to tax disparities” but is instead attributable to the taxing State’s discriminatory policies alone.

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92 Maryland Comptroller’s Brief, supra note 31, at 26-44.
93 Wynne, at 1802.
94 Wynne, 135 S.Ct. at 1802 (2015) (citing Armco, 104 S.Ct. 2620, 644–646; Moorman, 98 S.Ct. 2340; Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425,
When the Supreme Court applied the internal consistency test to Maryland’s tax regime, it found the Maryland regime internally inconsistent, as had the Maryland Court of Appeals. Unlike the Maryland Court of Appeals, which applied the test as a matter of doctrine, however, the Court in *Wynne* emphasized the connection between the test and economic analysis provided by us and the Tax Economists. The Court noted that the Maryland regime “has the same economic effect as a state tariff, the quintessential evil targeted by the dormant Commerce Clause.” It described the modern dormant Commerce Clause as “looking to the economic impact of the tax.” And it noted that “Neither [the Maryland Comptroller] nor the principal dissent questions the economic bona fides of the internal consistency test.” In particular, the Court for the first time implicitly acknowledged that internal consistency tests for adherence to competitive neutrality:

"the internal consistency test reveals what the undisputed economic analysis shows: Maryland’s tax scheme is inherently discriminatory and operates as a tariff. . . . This identity between Maryland’s tax and a tariff is fatal because tariffs are “[t]he paradigmatic example of a law discriminating against interstate commerce.”"

In affirming the usefulness of the internal consistency test in identifying the tariff-like impact of the Maryland tax, the Supreme Court cited our amicus brief and that of the Tax Economists. The Court later reiterated that the purpose of the internal consistency test was to identify taxes that distort competitive neutrality when it declared that:

In this case, the internal consistency test and economic analysis. . . confirm that the tax scheme operates as a tariff

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96 *Wynne*, at 1804.

97 *Wynne*, at 1792.

98 *Wynne*, at 1802. *See also Wynne*, at 1804 (reiterating that “None of our dissenting colleagues dispute this economic analysis.”)


100 *Id.*
and discriminates against interstate commerce, and so the scheme is invalid.

The tax regime violated the dormant Commerce Clause because it upset comparative advantage—it violated competitive neutrality and was thereby functionally equivalent to a tariff.

Importantly, eight of the nine justices agreed that the Constitution does not categorically forbid double taxation, and it does not contain a priority rule that says that residence taxes must give way to source taxes.\(^{101}\) Thus, whereas most states avoid double taxation on a residence basis, as do most countries—\(Wynne\) makes clear that that outcome is not constitutionally required.

**VI. THE PRINCIPAL DISSENT**

In applying the internal consistency test, the Court adopted by reference our economic analysis for determining when a state tax discourages cross-border commerce. But the majority merely referred to the economic analysis in our amicus brief and that of the Tax Economists.\(^{102}\) It did not describe it or explain how that analysis applied to the facts in \(Wynne\). Additionally, the majority borrowed language from the litigants who erroneously framed the case as asking whether double taxation was unconstitutional.\(^{103}\) Nor did the dissenting justices engage with the economics. Writing for the principal dissenters, Justice Ginsburg wrote that “[t]he majority faults the dissent for not ‘disputing’ its ‘economic analysis,’ but beyond to citation to a pair of amicus briefs, its opinion offers no analysis to dispute.”\(^{104}\)

Justices Scalia and Kagan join Justice Ginsburg’s dissent, much of which reads as if the dissenting justices understood the majority opinion to hold that the dormant Commerce Clause forbids double taxation.\(^{105}\)

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\(^{101}\) \(Wynne\), 135 S.Ct. at 1805 (“We establish no such rule of priority”). \(Id.\) at 1813 (Ginsburg, J., dissenting) (“nothing in the Constitution or in prior decisions of this Court dictates that one of two States, the domiciliary State or the source State, must recede simply because both have lawful tax regimes reaching the same income”).

\(^{102}\) \(Wynne\), 135 S.Ct. at 1804.

\(^{103}\) \(Wynne\), 135 S.Ct. at 1801.

\(^{104}\) \(Wynne\), 135 S.Ct. at 1822, n.7 (Ginsburg, J., dissenting) (quote marks in original; citation omitted).

\(^{105}\) \(E.g., Wynne\), 135 S.Ct. at 1810 (Scalia, J., dissenting) ([t]oday’s enterprise of eliminating double taxation”)’ Ginsburg, at 14 (Describing as the first reason for why the Court struck down the Maryland tax as “the tax creates a risk of double taxation”); \(Wynne\), 135 S.Ct. at 1822, n.10 (Ginsburg, J., dissenting) (given the concern that purportedly drives the Court’s analysis, it is a mystery why the Court sees virtue in
Likewise, the dissenters understood the majority to use the internal consistency test as a tool to combat double taxation.\textsuperscript{106}

In this Part, we show that the dissenting justices misunderstood the majority’s reasoning. The Court endorsed the internal consistency test as a tool for determining when a state discriminates, that is, when it violates competitive neutrality by upsetting comparative advantage.\textsuperscript{107} But the internal consistency test does not identify double taxation, and the majority did not use it for that purpose. In fact, the majority expressly disclaimed the notion that all double taxation violates the Constitution.\textsuperscript{108} Once we understand the distinction the majority drew between discrimination and double taxation, many of the concerns raised by Justice Ginsburg in her principal dissent and by Justice Scalia in his separate dissent disappear.

The dissenters’ make five main economic and policy (as opposed to doctrinal) arguments against using internal consistency to test for discrimination.\textsuperscript{109} First, the test is abstract and hypothetical; second, it does not root out double taxation. Third, the test is deeply flawed because Maryland could satisfy internal consistency by eliminating its inbound tax on nonresidents, even though such relief would not help the Wynnes. Fourth, the test must not identify taxes that are equivalent to tariffs because the Maryland tax does not resemble or function as a tariff since it striking down only one of the two schemes in which Bob is taxed twice”) (emphasis omitted).

\textsuperscript{106} E.g., \textit{Wynne}, 135 S.Ct. at 1822 (Ginsburg, J., dissenting) (“[t]he Court characterizes internal consistency as a ‘cure,’ but the test is scarcely that, at least for the double taxation the Court believes to justify its intervention.”); \textit{Id.} at 1822 (“the double tax burden the test is purportedly designed to cure”) (quotation marks omitted).

\textsuperscript{107} \textit{Wynne}, 135 S.Ct. at 1802–03.

\textsuperscript{108} \textit{Wynne}, 135 S.Ct. at 1804.

\textsuperscript{109} The dissenters also offer several interpretive and precedential arguments, which if accepted, would leave no room for internal consistency. For example, Justices Scalia and Thomas both express skepticism that the Constitution includes a dormant Commerce Clause. \textit{Wynne}, 135 S.Ct. at 1808–10 (Scalia, J., dissenting); \textit{Wynne}, 135 S.Ct. at 1811–14 (Thomas, J., dissenting). A majority of the Court, however, has long held otherwise. The principal dissent also argues that prior cases strongly support upholding Maryland’s tax. \textit{Wynne}, 135 S.Ct. at 1814–23 (Ginsburg, J., dissenting). In contrast, the Court argues that the cases strongly support striking down the Maryland tax. \textit{Wynne}, 135 S.Ct. at 1795–1807. Although we agree more closely with the majority than the dissent here, we view many of the cases as inconsistent with one another. Along these lines, Justice Scalia argues that “a conspicuous feature” of the Court’s tax discrimination doctrine has been “its instability” and characterizes jurisprudence as producing “a bestiary of ad hoc tests.” \textit{Wynne}, 135 S.Ct. at 1809 (Scalia, J., dissenting). We do not defend the history of the Court’s tax discrimination jurisprudence, but rather offer a method the Court can use to quickly and sensibly determine whether a given state tax discourages interstate commerce.
taxes in-state and interstate income at the same rate, whereas the defining characteristic of a tariff is that interstate activity is taxed more heavily than in-state activity. *Fifth*, the internal consistency test “boxes in” states and undercuts state tax sovereignty. Although many of these criticisms overlap, we take them in turn.

A. *Internal Consistency is Abstract and Hypothetical*

The dissenting justices (as well as commentators) have criticized the hypothetical nature of the internal consistency test. The test operates by asking courts to make a counterfactual assumption, namely, that other states adopt the same tax system as the challenged state. The Court then determines in this hypothetical world whether cross-border commerce bears more tax than domestic commerce. Of course, states do not all share the same tax system so the constitutional inquiry strays from reality.

Critics have not made clear what disadvantages derive from the abstract and hypothetical nature of the internal consistency test. The test might seem unusual, but it closely mirrors our uniformity principle, which itself is firmly grounded in economic principles. Uniformity is the key to nondiscrimination because it focuses on comparative advantage, rather than absolute advantage. If we are right that the tax nondiscrimination principle in the dormant Commerce Clause aims to eliminate tax-induced distortions of comparative advantage, then internal consistency is the right test to use because it correctly identifies tax-induced distortions to comparative advantage. That the test takes an unusual, abstract, or hypothetical form is irrelevant.

B. *Internal Consistency Does Not Prevent Double Taxation*

The principal dissent and Justice Scalia criticize the internal consistency test because it fails to root out all cases of double state taxation. This criticism is unpersuasive because it is based on the

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111 *Tax Discrimination*, supra note 24, 1060-1074.

112 For the doctrinal case for interpreting the dormant Commerce Clause to promote competitive neutrality, see Lirette & Viard, *supra* note 25 (relabeling the competitive neutrality concept we introduced in our work focused on the EU as “commerce neutrality” for the U.S. context).

113 Justice Scalia’s observation that the majority opinion does not eliminate all double taxation leads him to conclude that the Court’s ruling leads to “imaginary benefits”. *Wynne*, 135 S.Ct. at 1811 (Scalia, J., dissenting).
erroneous assertion that the majority in *Wynne* interpreted the dormant Commerce Clause to forbid double taxation.\textsuperscript{114}

In her opinion for the principal dissent, Justice Ginsburg offered a simple and ostensibly powerful example of the failure of the internal consistency test to root out double taxation. She asked what would happen if Virginia taxed exclusively on a residence basis and offered no credits for source taxes, while simultaneously Maryland taxed exclusively on a source basis? She explained that Maryland and Virginia would each individually satisfy the internal consistency test. However, in actual practice (as opposed to the abstraction of the internal consistency test), the combination of these systems could result in full double taxation.\textsuperscript{115} Virginia residents with Maryland income would be taxed twice (first by Maryland on a source basis and then by Virginia on a residence basis).\textsuperscript{116} Justice Scalia made similar points.\textsuperscript{117}

It is worth restating more generally the dissenters’ objection: internal consistency as a test of state tax discrimination would not prevent one state from taxing exclusively on a source basis while another state taxed exclusively on a residence basis with no credit for source taxes, even though the simultaneous application of such systems could result in unrelieved double tax. However, the majority in *Wynne* did not hold that all double taxation violates the Constitution. On the contrary, the Court noted the existence of a “critical distinction. . . between discriminatory tax schemes and double taxation that results only from the interaction of two different but nondiscriminatory tax schemes.”\textsuperscript{118}

Double taxation is neither a necessary nor sufficient condition for tax discrimination. We briefly review the distinction between double taxation and discrimination.

Obviously, a state can discriminate against cross-border commerce without imposing double taxation. Assume, for example, Maryland is the

\textsuperscript{114} Justice Scalia erroneously characterizes the majority opinion as “[t]oday’s enterprise of eliminating double taxation.” *Wynne*, 135 S.Ct. at 1810 (Scalia, J., dissenting).

\textsuperscript{115} The combination of these schemes also could result in single taxation or “double non-taxation,” where some taxpayers are not taxed at all. Single taxation would result for Maryland residents with only Maryland income and Virginia residents with only Virginia income. Double non-taxation would result for Maryland residents with only Virginia income.

\textsuperscript{116} *Wynne*, 135 S.Ct. at 1822 (Ginsburg, J., dissenting).

\textsuperscript{117} *Wynne*, 135 S.Ct. at 1808–09 (Scalia, J., dissenting). See also Cummings, supra note 110.

\textsuperscript{118} *Wynne*, 135 S.Ct. at 1804.
only state to tax, and assume that Maryland exempts residents’ out-of-state income, maintains a 3% tax rate on residents’ domestic income, and taxes nonresidents’ Maryland income at 5%. Even if no other state imposed taxes, so that there would be no double tax, Maryland would discriminate against cross-border commerce. Nonresidents would face a tax-induced disadvantage compared to Maryland residents on income earned in Maryland because nonresidents would retain proportionately less of their income earned in Maryland relative to what they would retain of their revenue earned outside of Maryland as compared to nonresidents.\textsuperscript{119}

To show that unrelieved double tax need not be discriminatory, we need to flesh out Justice Ginsburg’s example. Assume Maryland imposes only a 20% source tax, and Virginia imposes only a 10% residence tax. Maryland residents with Virginia income would pay no tax; Virginia residents with Virginia income would pay only the Virginia 10% residence tax; Maryland residents with Maryland income would pay only the Maryland 20% source tax; and Virginia residents with Maryland income would pay both the Virginia 10% residence tax and the Maryland 20% source tax, for a combined tax rate of 28%.\textsuperscript{120}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
\textbf{INCOME SOURCED IN VIRGINIA} & \textbf{INCOME SOURCED IN MARYLAND} \\
\hline
$T_{outbound}^{MD} = 0\%$ & $T_{outbound}^{MD} = 0\%$ \\
$T_{inbound}^{VA} = 0\%$ & $T_{inbound}^{VA} = 10\%$ \\
$T_{domestic}^{MD} = 20\%$ & $T_{domestic}^{MD} = 20\%$ \\
$T^{VA} = N/A$ & $T^{VA} = 10\%$ \\
\hline
\end{tabular}
\caption{Nondiscriminatory Double Taxation}
\end{table}

\textsuperscript{119} Nonresidents retain 95% as much of their income when they earn income in Maryland rather than outside Maryland whereas residents retain 97% as much. Thus, Maryland taxes provide Maryland residents with a comparative advantage over nonresidents in Maryland.

\textsuperscript{120} This assumes that a residence state would assess its tax upon the after-source-tax income of its residents (i.e., no gross-up). Thus, the combined tax rate of 28% is calculated as follows: Virginia residence tax [10\%] + Maryland source tax [20\%] – (Virginia residence tax x Maryland source tax [2\%]).
Each of the Maryland and Virginia tax regimes is internally consistent. Yet, when Maryland applies its regime at the same time that Virginia applies its own, different (but also internally consistent) regime, differences arise in the number of times taxpayers are taxed (none, once, or twice) and in total tax rates they pay (0, 10%, 20% and 28%). Thus, the test does not identify—nor should it—a tax regime as constitutionally infirm simply because it results in different taxpayers paying tax at different absolute rates or because it results in double taxation. This is the right result because, as we explain below, despite the tax differences the proposed Maryland and Virginia regimes generate, neither regime impairs any taxpayer’s comparative advantage.

The internal consistency test generates the proper result under an interpretation of nondiscrimination that promotes competitive neutrality and that recognizes that competitiveness depends upon comparative, not absolute, advantage. The aim of the dormant Commerce Clause is not to harmonize tax rates or ensure that cross-border taxpayers always pay the same tax rates as domestic taxpayers. Nor, as the majority in *Wynne* made clear, is it to alleviate double taxation. On the contrary, the dormant Commerce Clause prevents states from using their tax systems to favor in-state commerce over cross-border commerce. And, in the example Justice Ginsburg gave, neither the Maryland nor Virginia system (alone or together) favors domestic over interstate commerce.

Neither state’s tax policy upsets competition because each state’s tax regime applies uniformly. The Virginia tax applies on a uniform residence basis; Virginia residents pay the Virginia tax whether they earn domestic or outbound income. The Maryland tax applies on a uniform source basis; residents of both Maryland and Virginia pay the Maryland source tax on their Maryland-source income. As a result, Virginia residents take home 10% less after taxes than do Maryland residents with the same pre-tax income. Because that 10% difference exists whether that income arises in Virginia or Maryland, the Virginia residence tax does not distort competition between residents of Virginia and Maryland. Similarly, everyone takes home 20% less after taxes on each dollar of income earned in Maryland as opposed to Virginia. Because that same 20% difference

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121 See discussion in *supra* note 120.

122 The Maryland tax is internally consistent because if all states adopted the Maryland tax system, all states would impose a 20% source tax and only a 20% source tax. Thus, both domestic and cross-border income would be taxed at 20%. Similarly, the Virginia tax is internally consistent because if all states adopted the Virginia tax system, all states would impose a 10% residence tax and only a 10% residence tax. Thus, both domestic and cross-border income would be taxed at 10%.

123 See discussion accompanying *supra* notes 125 to 126.

124 *Wynne*, 135 S.Ct. at 1794–95.
exists regardless of whether the income is earned by a Virginia resident or a Maryland resident, the Maryland source tax does not distort competition either. Moreover, the two taxes together do not distort competition between Maryland and Virginia residents for income in Delaware and Maryland because both Virginia and Maryland residents retain 80% as much of their pre-tax income when they earn income in Maryland as compared with when they earn income in Virginia.125

Thus, competition is not distorted because residents of Virginia and Maryland both retain proportionately (in the example both retain 80%) as much of their before-tax income when they earn income in Maryland as opposed to Virginia. In order for a tax system to distort competition, it must produce a difference in these ratios across residents of different states.126

Intuition might lead to the conclusion that unrelieved double taxation always distorts competition between taxpayers, but the kind of economic analysis we just provided shows the fallacy of that intuition. Sometimes, double taxation upsets competition, but other times it does not. The majority understands this elusive point when it explicitly refers to nondiscriminatory double taxation.127

Indeed, what made Wynne such a conceptually difficult case was precisely that it involved discriminatory double taxation. Moreover, as both the majority and principal dissent acknowledged, Maryland could satisfy the internal consistency test (and eliminate the discrimination) by taking steps that would eliminate or reduce the double taxation, such as reducing or eliminating outbound taxation, crediting foreign taxes, or eliminating inbound taxation. But Maryland could also achieve internal consistency (and eliminate discrimination) without alleviating double taxation: For example, Maryland could raise the domestic tax rate (the tax paid by Maryland residents on Maryland-source income) so that it equals the combined tax on inbound and outbound income.

That Maryland can satisfy the internal consistency test (and cure discrimination) by raising the domestic tax rate, which does nothing to

125 Maryland residents retain 80% of their Maryland income and 100% of their Virginia income; Virginia residents retain 72% of their Maryland income and 90% of their Virginia income. Because 72% is 80% of 90%, the tax systems do not change the relative amounts kept by residents of Virginia and Maryland for investments in each state. Thus, the Maryland and Virginia taxes (separately and together) do not distort competition because they do not change comparative advantage.

126 Tax Discrimination, supra note 24, at 1060-1074.

127 Wynne, 135 S.Ct. at 1804 (calling the difference between discrimination and double taxation a “critical distinction”).
eliminate or reduce double taxation, is not a problem with or a flaw of the internal consistency test, but rather underscores that the internal consistency test in particular, and tax discrimination doctrine in general, are about preserving comparative advantage. That is, the dormant Commerce Clause prohibits discrimination, not double taxation.

Thus, the principal dissenters are correct that the internal consistency test will not identify all cases of double taxation, but they are wrong that this is a problem with the test. The beauty of the internal consistency test is its ability to distinguish between discriminatory and nondiscriminatory double taxation. Indeed, the internal consistency test does a much better job than unaided intuition in determining whether a tax system distorts competition. Given that the Court has interpreted the dormant Commerce Clause to forbid only discriminatory double taxation, a test like internal consistency that can reliably distinguish discriminatory from nondiscriminatory double tax is invaluable.

That does not mean that the taxes in Justice Ginsburg’s example create no distortions. In our modified version of Justice Ginsburg’s example, the Virginia tax discourages Virginia residence, while the Maryland tax discourages earning income in Maryland. But neither tax, nor the combination of the two tax systems, gives a resident of Maryland or Virginia an edge over a resident of the other state in securing a job or making an investment in either state. In other words, the tax regimes (implemented together or alone) do not distort competition between residents of Maryland and Virginia for work and investment in Maryland or Virginia. The tax regimes do not distort competition between the taxpayers, despite the fact that some taxpayers experience double taxation.

C. Maryland Could Satisfy Internal Consistency Via Methods that Would Not Benefit the Wynnes

The principal dissent makes another argument that overlaps with its argument that internal consistency test does not eliminate all cases of double taxation. The dissenters criticize the internal consistency test because Maryland can satisfy it by amending its law in a way that would not benefit the Wynnes. Justice Ginsburg writes:

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Maryland could eliminate the inconsistency by terminating the [inbound tax]—a measure that would not help the Wynnes at all. Maryland could, in other words, bring itself into compliance with the test at the heart of the Court’s analysis without removing the double tax burden the test is purportedly designed to “cure.”

Justice Ginsburg is correct; Maryland could resolve its constitutional infirmity by taking any of the following actions: (1) lowering the outbound tax rate, (2) crediting out-of-state taxes, (3) raising the domestic tax rate, or (4) eliminating the inbound tax. Any of the four options (and countless combinations of them) would satisfy the internal consistency test, but only the first two would decrease the Wynnes’ absolute tax burden.

According to the principal dissent, the possibility that Maryland could cure its constitutional violation without directly benefiting the Wynnes reveals “a deep flaw” in the Court’s internal consistency test. The majority responded to the dissent’s criticism by arguing that remedies in discrimination cases often take this form: the discrimination can be cured by leveling up the treatment of the disfavored group, or leveling down the treatment of the favored group. But the principal dissent argued that the situation was different in Wynne because levelling up the treatment of the nondiscriminated class by lowering the inbound tax will only benefit nonresidents in Maryland. It would do nothing, in the dissenters’ view, to help residents like the Wynnes, who, according to the majority, faced discrimination by Maryland against their out-of-state income.

This criticism fails to recognize that taxes impact competition by changing comparative advantage, not by changing absolute advantage. It is true that fixing the constitutional infirmity by one of the latter two options—raising the domestic tax or eliminating the inbound tax—will not reduce the Wynnes’ absolute tax burden. It would, however, improve their competitive position. For example, it might be counterintuitive, but the

129 Wynne, 135 S.Ct. at 1822 (Ginsburg, J., dissenting).
130 Wynne, 135 S.Ct. at 1806 (citing Knoll & Mason Brief, supra note 22, at 28–30).
131 Wynne, 135 S.Ct. at 1822–23 (Ginsburg, J., dissenting). In addition, the third option, raising the domestic tax rate, would also cure the discrimination, but would not appear to benefit the Wynnes directly either. That option was not discussed by the principal dissent.
132 Wynne, 135 S.Ct. at 1822 (Ginsburg, J., dissenting).
133 Wynne, 135 S.Ct. at 1823 (Ginsburg, J., dissenting).
inbound tax actually disadvantages the Wynnes in their competition with non-Maryland residents outside of Maryland. As a result, lowering or repealing the inbound tax would confer an advantage upon the Wynnes and all other Marylanders who compete for income outside the state.

To see why this is so, return to our two-state example, where Virginia represents all states other than Maryland. Residents of both Virginia and Maryland allocate investment and work effort between Virginia and Maryland. Because Virginia and Maryland are the only two markets, a taxpayer’s competitive position in Virginia depends upon how that taxpayer is taxed in Virginia relative to how that taxpayer is taxed in Maryland as compared to how that taxpayer’s competitors are taxed in Virginia relative to how they are taxed in Maryland. Accordingly, eliminating the inbound tax would improve the competitive position Virginia residents in Maryland, thereby worsening their competitive position in Virginia, thus benefitting the Wynnes.

In other words, the Maryland tax regime held unconstitutional by the Court has two effects that go in opposite directions: it keeps residents in, and it keeps nonresidents out. It is protectionist and retentionist. We have argued that such bidirectional distortions are the hallmark of tax discrimination, but they are not always obvious. It is obvious that the inbound tax discourages Virginia residents from earning income in Maryland; the tax protects the Maryland market from Virginia residents. But, although less obvious, Maryland’s protectionism impacts the market in Virginia, too. By using the inbound tax to keep Virginia residents out of Maryland, Maryland makes it harder for its own residents to compete with Virginia residents in Virginia. Eliminating the inbound tax would bring more Virginia residents into Maryland, freeing up opportunities for Marylanders in Virginia. Thus, despite the principal dissent’s argument, eliminating Maryland’s inbound tax would benefit the Wynnes by making it easier for them to compete in Virginia.

D. The Tariff Critique

Because Maryland taxed the Wynnes’ Maryland income at the same rate as their out-of-state income, Justice Ginsburg objected that the majority’s use of the term “tariff” to refer to the Maryland tax regime was inapt. She wrote:

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134 See generally Tax Discrimination, supra note 24, at 1056-1060 (referring to a two-directional distortion”).

135 For formal analysis of this phenomenon, see Tax Discrimination, supra note 24, at 1057-1060 (analyzing residence-based distortions of competitive neutrality).
The majority asserts that because Maryland’s tax system is internally inconsistent, it “operates as a tariff” making it “patently unconstitutional.” This is a curious claim. The defining characteristic of a tariff is that it taxes interstate activity at a higher rate than it taxes the same activity conducted within the state. Maryland’s resident income tax does the exact opposite: It taxes the income of its residents at precisely the same rate, whether the income is earned in-state or out-of-state.\footnote{136}

The Court uses the term “tariff” to describe taxes that fail the internal consistency test. Lirette and Viard introduced the tariff analogy in their work, and the Tax Economists used it throughout their amicus brief. The Court adopted the Tax Economists’ terminology, but it did not explain why. The Part explains why the tariff analogy is appropriate.

When a challenge is to a state’s tax rates, the internal consistency test requires a state’s domestic tax rate to equal or exceed its combined outbound and inbound tax rates.\footnote{137}

If the domestic rate equals the combined incoming and outgoing rates, then the tax system is neutral towards cross-border commerce.\footnote{138}

If, however, the domestic tax rate exceeds the combined incoming and outgoing rates, the tax system prefers cross-border commerce over domestic commerce. That is, the state creates a tax-induced competitive advantage for its residents over nonresidents when earning income outside the state, and it simultaneously creates a tax-induced competitive advantage for nonresidents over its own residents when earning income within the state. Such tax regimes are sometimes referred to as “reverse discrimination,” but so far, the Supreme Court has not invalidated them under the dormant Commerce Clause.\footnote{139}

\footnote{136} \textit{Wynne}, 135 S.Ct. at 1822 (Ginsburg, J., dissenting).

\footnote{137} See discussion \textit{supra} Part IV.

\footnote{138} That is to say, apply \textit{Equation 1} with an equality instead of an inequality.

\footnote{139} See \textit{West Lynn Creamery, Inc. v. Healy}, 512 U.S. 186, 199 (1994) (striking down a Massachusetts direct subsidy to in-state milk producers because it was funded by a tax on in-state and out-of-state milk wholesalers, but declaring that “a pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business”). But see \textit{Cuno v. DaimlerChrysler, Inc.}, 386 F.3d 738 (6th Cir. 2004) (vacated in part by \textit{DaimlerChrysler Corp. v. Cuno}, 126 S.Ct. 1854 (2006) ((invalidating under the Commerce Clause a tax credit extended by Ohio against its franchise tax to DaimlerChrysler in exchange for the company’s location of assets in Toledo).
The final possibility is that the domestic tax rate is less than combined incoming and outgoing tax rates. In this case, the tax system fails internal consistency and discourages cross-border commerce compared to domestic commerce. That is, the state creates a tax-induced competitive advantage for its residents over nonresidents when earning income inside the state, and it simultaneously creates a tax-induced competitive advantage for nonresidents over its own residents when earning income outside the state. The amount by which the state’s cross-border tax (i.e., the aggregate of the inbound and outbound taxes) exceeds the domestic tax is equivalent to an additional tax on interstate income (compared to domestic income). That additional tax can be thought of as functionally equivalent to a tariff on interstate commerce.

The internal consistency test shows that Maryland taxes domestic commerce at 3.2% and interstate commerce at 4.45%. There are many ways of thinking about Maryland’s additional 1.25% tax on interstate commerce as a tariff, and we consider two here. One way to think about the Maryland tax regime is that it functions as an import tariff. The import tariff emerges when we decompose the Maryland regime into: (1) a uniform 3.2% residence tax on both domestic and outbound activities (in Figure 4, the taxes inside the dashed line), which leaves (2) a residual non-uniform 1.25% tax on inbound income (in Figure 4, the taxes inside the dotted line).

140 We consider the two extremes here: either the whole 1.25% extra burden on interstate commerce functions as an import tariff, or it wholly functions as an export tariff.

<table>
<thead>
<tr>
<th>Activity in Another State</th>
<th>Maryland Resident</th>
<th>Resident of Another State</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Uniform residence tax: 3.2%</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Activity in Maryland</td>
<td>(1) Uniform residence tax: 3.2%</td>
<td>(2) Non-uniform source tax: (import tariff): 1.25%</td>
</tr>
</tbody>
</table>

**Figure 4. Maryland Tax Regime as Import Tariff**
Under this decomposition, the 1.25% non-uniform inbound tax is analogous to a 1.25% import tariff because it discourages nonresidents from engaging in economic activities in Maryland.

Another way to think about the Maryland tax regime is that it functions as an export tariff. The export tariff emerges when we decompose the Maryland regime into: (1) a 1.95% uniform residence tax on both domestic and outbound activities (in Figure 5, the taxes inside the long dashed line), plus (2) a 1.25% uniform source tax on Maryland activities by both residents and nonresidents (in Figure 5, the taxes inside the short dashed line). This decomposition leaves (3) a residual (non-uniform) 1.25% on residents’ outbound income (in Figure 5, the taxes inside the dotted line):

**FIGURE 5. MARYLAND TAX REGIME AS EXPORT TARIFF**

<table>
<thead>
<tr>
<th>ACTIVITY IN ANOTHER STATE</th>
<th>MARYLAND RESIDENT</th>
<th>RESIDENT OF ANOTHER STATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Uniform residence tax: 1.95%</td>
<td>(3) Non-uniform residence tax (export tariff): 1.25%</td>
<td>N/A</td>
</tr>
<tr>
<td>ACTIVITY IN MARYLAND</td>
<td>(1) Uniform residence tax: 1.95%</td>
<td>(2) Uniform source tax: 1.25%</td>
</tr>
</tbody>
</table>

The non-uniform tax on residents’ outbound income functions as an export tariff because it discourages Maryland residents from earning income outside Maryland.

The preceding exercise underscores several important points. First, like tariffs, discriminatory income taxes distort production. Discriminatory income taxes distort where people produce income just as tariffs distort
where people produce goods and services. Second, tariffs and discriminatory income taxes distort via the same mechanism: they upset comparative advantage. Third, our demonstration that there are multiple ways to decompose an internally inconsistent tax regime—into an internally consistent tax plus a residual, where the residual functions as a tariff—underscores the importance of considering domestic, inbound, and outbound tax rates together to assess discrimination. It also highlights the two-directional aspect of discriminatory taxes. Discriminatory taxes simultaneously discourage inbound and outbound commerce. This effect, too, is similar to tariffs.

Our exercise in decomposing Maryland’s tax regime into, alternatively, a uniform-source-tax-with-a-residual or a uniform-residence-tax-and-an-uniform-source-tax-with-a-residual aids in understanding the tariff analogy, but it is not necessary for a court to reconceptualize the challenged tax regime in those ways. All a court has to do to determine if the tax discriminates is to apply the internal consistency test. Economic analysis shows that a failure of internal consistence means the tax regime functions as a tariff.

E. The State Sovereignty Critique

Justice Ginsburg for the principal dissent and Justice Scalia writing separately both argued that the Court’s dormant Commerce Clause doctrine compromises state sovereignty. The principal dissent argued that the Court’s holding in Wynne “boxes in the taxing authority of a taxpayer’s domicile.” This Part responds that the notion that the dormant Commerce Clause constrains or “boxes in” state taxes is not new. Moreover, the majority’s renewed commitment to the internal consistency test helps preserve state tax sovereignty because it allows states broad discretion in setting their taxes.

1. Majority “Boxes In” States

The principal dissent correctly observes that the majority’s decision implies that a state’s source taxes “box in” that same state’s residence taxes. The internal consistency test precisely states the nature

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141 Put another way, discriminatory income taxes distort who works what job or owns which asset; tariffs distort which country produces which goods and services.

142 Wynne, 135 S.Ct. at 1813 (Ginsburg, J., dissenting).

143 Although the “boxing in” language is somewhat colloquial, neither the meaning nor the import of the claim are clearly explained by the principal dissent. Indeed, the principal dissent seems to be making two somewhat different claims with its “boxing in” criticism. In the first use of the phrase, the principal dissent seems to be claiming that the Court holds how a source state taxes income “boxes in” how another state (that of a taxpayer’s residence) can tax a resident taxpayer with income in the first
of that constraint: a state’s tax on cross-border income (comprised of its tax on inbound income plus its tax on outbound income) cannot be greater than its tax on domestic income. In other words, the state’s tax rates must obey Equation 1, $T_d \geq T_o + T_i - (T_o \times T_i)$.\textsuperscript{144}

We are not sure why the dissent considers such constraints to be a problem, especially since the dissenters’ preferred rule would also “box-in” the states. Rather than arguing, as did Justice Thomas,\textsuperscript{145} that the dormant Commerce Clause places no constraints on how states may tax interstate commerce, the principal dissent argued that states violate the dormant Commerce Clause when they assess higher absolute tax rates on inbound or outbound commerce than on domestic commerce.\textsuperscript{146} In other words, like the Maryland Comptroller, the principal dissent reads the constitutional requirement as equivalent to Equation 2, $T_d \geq T_i$ and $T_d \geq T_o$. Like Equation 1, Equation 2 also “boxes in” how states may tax. Setting any one of the variables in Equation 2 provides Maryland an upper bound on at least one other rate.\textsuperscript{147} Thus, under both the Court’s and the principal dissent’s articulation of the test for tax discrimination, states lack unfettered tax discretion, and a decision by a state about how to tax on either a source or residence basis will restrain how that state can tax on the other basis.

source state. Neither the internal consistency test nor the uniformity principle restrict how one state (say Maryland) can tax on how a second state (say Virginia) taxes. In the second use of the phrase, “[m]y objection, rather, is that the Court treats source-based authority as ‘boxing in’ a State’s discrete authority to tax on the basis of residence” \textit{Wynne}, 135 S.Ct., at 1822, n. 9 (Ginsburg, J., dissenting). Likewise, Justice Ginsburg asserts that “the Constitution… does not require one State, in this case Maryland, to limit its residence-based taxation, should the [same] State also choose to exercise, to the full extent, its source-based authority.” \textit{Id.} at 1814. These descriptions of the implications of the majority’s holdings, that a state’s own residence taxation constrains that same state’s source taxation, are accurate and so we assume that this second claim is the import of the principal dissent’s criticism.

\textsuperscript{144} This is true for cases, like \textit{Wynne}, that involve a challenge only to tax rates. For challenges involving credits or tax base, the analysis is more complicated. See generally Perseus, supra note 24. Although the principal dissent does not mention it, another direct implication of the Court’s ruling is that how a state taxes on a residence basis also boxes in how it can tax on a source basis. Under the majority’s holding, a state’s source taxes constrain its residence taxes, and its residence taxes constrain its source taxes.

\textsuperscript{145} \textit{Wynne}, 135 S.Ct., at 1811-1813 (Thomas, J., dissenting).

\textsuperscript{146} \textit{Wynne}, 135 S.Ct., at 1818, n. 5 (Ginsburg, J., dissenting).

\textsuperscript{147} If the state sets the tax rate on domestic income ($T_d$), then the tax rates on inbound ($T_i$) and outbound ($T_o$) income can be no higher than that rate. If the state sets the tax rate on either inbound or outbound income, then the tax rate on domestic income, must be at least that high, but the other tax rate is not constrained until the domestic tax rate is set. Under Equation 1, the uniformity principle, states can set two tax rates independently of one another, but then the third tax rate is constrained.
Moreover, that the Commerce Clause restrains state tax sovereignty is hardly new. Thus, the disagreement between the majority and the principal dissenters in *Wynne* is best understood as a disagreement over economics: When do state taxes discourage cross-border commerce in a constitutionally relevant way? Maryland and the dissenters argue that states only violate the Constitution when they assess lower taxes on domestic income than *either* inbound or outbound income. But if the goal is to prevent states from discouraging interstate commerce compared to instate commerce, then the correct standard to use from an economics perspective is one that compares the state’s domestic tax to the aggregate of its taxes on inbound and outbound income. The internal consistency test is a quick, easy, and reliable way to compare the challenged state’s domestic tax to the aggregate of its inbound and outbound taxes.

In contrast, taxing domestic, inbound, and outbound income all at the same rate without providing a credit for out-of-state taxes, which would be permitted under an interpretation of the dormant Commerce Clause that it required fidelity only to *Equation 2*, would discourage cross-border commerce relative to domestic commerce. The principal dissent’s position would open the floodgates to state taxes that function as tariffs, even though the dissenters recognize that the purpose of the dormant Commerce Clause doctrine is to prevent such obstacles to the national market.

It is neither a surprise nor a devastating criticism that the dormant Commerce Clause constrains state taxes. The Court has long held that the dormant Commerce Clause boxes in the states. We have shown that the internal consistency test reveals whether a challenged state exceeds its tax authority by assessing unconstitutionally discriminatory taxes that impair interstate commerce by upsetting competitive neutrality. A virtue of the internal consistency test is that it goes no farther than necessary to achieve this goal. For example, under the majority’s analysis and under the internal consistency test, Maryland’s choices about its source taxes constrain its own residence taxes and vice versa. But other states’ tax rate choices constrain neither Maryland’s source nor its residence taxes. Under a competitive neutrality conception of nondiscrimination, each state sets its taxes independently of every other state, but no state may set its source taxes independently of its own residence taxes, or vice versa.

Thus, the uniformity principle and internal consistency provide states with a wide range of discretion, but not with unfettered discretion. States have wide flexibility to set tax rates high or low, to allocate tax liability between residence and source states, and to tax progressively or not. At the same time, there are also clear lines that states cannot cross,

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148 *Perseus*, *supra* note 24, at 417-419.
where their policies discourage cross-border commerce relative to domestic commerce.

2. Concerns for State Tax Sovereignty

Justice Scalia argued that the Court usurped the role of state and national legislatures by balancing the needs of the national marketplace against the needs of state governments for revenue. Similarly, Justice Ginsburg argued that:

States deciding whether to tax residents’ entire worldwide income must choose between legitimate but competing tax policy objectives. A State might prioritize obtaining equal contributions from those who benefit from the State’s protection in roughly similar ways. Or a State might prioritize ensuring that its taxpayers are not subject to double taxation. A State cannot, however, accomplish both objectives at once.

And she concluded that:

This case is at bottom about policy choices: Should States prioritize ensuring that all who live or work within the state shoulder their fair share of the costs of government? Or must states prioritize avoidance of double taxation? As I have demonstrated, achieving even the latter goal is beyond this Court’s competence. Resolving the competing tax policy considerations this case implicated is something the Court is even less well equipped to do. For a century, we have recognized that state legislatures and the Congress are constitutionally assigned and institutionally better equipped to balance such issues.

This quotation illustrates that the principal dissent sees a conflict between fairness and efficiency. In their view, efficiency calls for the elimination of double taxation; fairness requires roughly equal contributions from residents who benefit from state-provided goods and services, no matter where they earn their income. The attainment of both would be ideal, in Justice Ginsburg’s view, but it is not possible. States must choose between them and balance.

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149 Wynne, 135 S.Ct. at 1810 (Scalia, J., dissenting).
150 Wynne, 135 S.Ct. at 1816 (Ginsburg, J., dissenting).
151 Wynne, 135 S.Ct. at 1823 (Ginsburg, J., dissenting).
We disagree. In our view, the uniformity principle is the path towards pursuing both goals. As described above, in the dormant Commerce Clause context efficiency requires uniformity; it requires maintenance of comparative advantage, but it does not require avoidance of double taxation.

Uniformity promotes fairness to both taxpayers and states. As the principal dissent recognizes, residents with cross-border income do not benefit twice as much from state policies than do residents with only in-state income. Rather, such residents’ derive benefits not only from their residence state, but also from all the other states where they earn income. Although the facts of Wynne highlight Maryland’s role as a residence state, Maryland is also a source state, and in that capacity, it confers benefits on nonresidents. The uniformity principle allows Maryland or any other state to decide how much tax liability to allocate to residence taxation and how much tax liability to allocate to source taxation. But it does not allow a state to design its residence tax independently of its source tax. States therefore have autonomy to allocate tax liability in line with the benefits principle, but they cannot discriminate against interstate commerce. Such an approach is consistent with taxing according to ability to pay because it permits states to tax their residents’ worldwide income with a credit for taxes paid to other jurisdictions, which is widely viewed as a fair method of taxing individuals.152

VII. CONCLUSION

Wynne is the Court’s most important state tax case in decades.153 Its significance is greater given the close decision, sharp divisions, and unusual alignment of justices in the final opinions. Because it acknowledges the economics behind the internal consistency test, Wynne provides a way out of “tangled underbrush” of dormant Commerce Clause doctrine to a future with clear, sensible decisions. While there may be some truth in Justice Scalia’s criticism that the Court’s interpretation of the dormant Commerce Clause prior to Wynne involved “ad hocery” that “lack[ed a] . . . governing principle,” the majority’s recognition of the economic principles undergirding the dormant Commerce Clause places the doctrine on firmer footing. And the Court’s confirmation that the internal consistency test should be applied to resolve any kind of state tax discrimination case gives lower courts clear direction.

The challenge of dormant Commerce Clause doctrine is balancing state tax sovereignty against the national interest in a smoothly functioning national economy that benefits U.S. workers, investors, and consumers.

152 Tax Discrimination, supra note 25, at 1027.

153 See references supra note 4.
By ruling out internally inconsistent state taxes, *Wynne* clarifies that balance. *Wynne* stands for the proposition that states have wide range to set their own tax regimes, but that flexibility comes to an abrupt end when a state enacts a tax regime that discriminates against interstate commerce. As our analysis shows, a state discriminates against interstate commerce when it discourages cross-border commerce relative to in-state commerce. Such discrimination tends to “balkanize” the national market by dividing it into separate state markets where residents have a competitive advantage over nonresidents. In *Wynne*, the Court endorsed the internal consistency test, which it had been moving away from for three decades, because economic analysis shows that the internal consistency test does a good job of identifying state taxes that discriminate interstate commerce.

To realize the potential of *Wynne*, however, the Court must remain true to its central conclusions in the case—first, the problem addressed by the dormant Commerce Clause is not double taxation, but rather discrimination against cross-border commerce; second, a state discriminates when it uses its tax system to upset comparative advantage, third, economic analysis supports the use of the internal consistency test to discover state tax violations of comparative advantages, fourth, the Constitution does not establish a priority rule between source and residence taxation, and fifth, discrimination claims can only be evaluated by examining the state’s full tax system, including its domestic, inbound, and outbound taxes.